IFAD

INTERNATIONAL FUND FOR AGRICULTURAL DEVELOPMENT

Executive Board – Seventy-Eighth Session

Rome, 9-10 April 2003

REPORT ON IFAD'S INVESTMENT PORTFOLIO FOR THE FIRST TWO MONTHS OF 2003

I. INTRODUCTION

1. The following report on IFAD's investment policy covers the two-month period ending 28 February 2003 and includes comparative figures for earlier years. A report on the first quarter of 2003 will be included as an annex to the report on the second quarter of 2003.

2. The report comprises the following six sections: investment policy, asset allocation, investment income, rate of return and performance comparison, currency composition and risk measurement.

II. INVESTMENT POLICY

3. IFAD's current investment policy was adopted in December 2001. The composition and characteristics of the investment policy are shown in Annex I.

4. The policy had been fully implemented in 2002 with the exception of the asset class of inflation-indexed bonds. As of 28 February 2003, this asset class remained unfunded due to the currently low yields, with the unfunded amount being held mainly in cash and time-deposits in the internally managed portfolio and, to a lesser extent, in the government bonds portfolio.

III. ASSET ALLOCATION

5. Table 1 shows the movements affecting the investment portfolio's major asset classes in the first two months of 2003 and compares the portfolio's actual asset allocation to the policy allocation. During the first two months of 2003, the main changes in the investment portfolio were due to overall positive movements in investment income and exchange movements. There was also a net inflow of USD 8 531 000 equivalent to the internally managed portfolio, representing cash receipts and encashments of Member States' contributions, less disbursements for loans, grants and administrative expenses. The above-mentioned movements increased the holdings of the internally managed and government bonds portfolios, while the amount of the equities portfolio decreased. At 28 February 2003, the portfolio showed excess allocations to the internally managed and government

bonds portfolios, reflecting the fact that the asset class of inflation-indexed bonds was still unfunded, as described in the previous paragraph.

Table 1: Summary of Movements in Cash and Investment – First Two Months of 2003
(USD ’000 equivalent)

	Internally Managed Portfolio	**Government Bonds Portfolio**	**Inflation-Indexed Bonds Portfolio[1]**	**Diversified Fixed-Interest Portfolio**	**Equities Portfolio**	**Overall Portfolio**
Opening balance (31 December 2002)	**408 137**	**1 022 378**	**-**	**464 218**	**199 260**	**2 093 993**
Gross investment income (loss)	876	19 094	-	6 824	(11 512)	15 282
Income from securities lending and commission recapture	-	11	-	2	3	16
Fees, charges and taxes	(20)	(469)	-	(218)	(144)	(851)
Net investment income (loss)	**856**	**18 636**	**-**	**6 608**	**(11 653)**	**14 447**
Transfers due to allocation	378	-	-	-	(378)	-
Transfers due to expenses	(776)	452	-	196	128	-
Transfers between portfolios[2]	**(398)**	**452**	**-**	**196**	**(250)**	**-**
Other net flows[3]	8 531	-	-	-	-	8 531
Movements on exchange	4 581	10 261	-	(17)	740	15 565
Closing balance (28 February 2003)	**421 707**	**1 051 727**	**-**	**471 005**	**188 097**	**2 132 536**
Actual allocation (%)	19.8	49.3	-	22.1	8.8	100.0
Policy allocation (%)	5.0	44.0	18.0	23.0	10.0	100.0
Difference in allocation (%)	**14.8**	**5.3**	**(18.0)**	**(0.9)**	**(1.2)**	**-**

1. The policy allocation has an allocation of 18% to inflation-indexed bonds. The asset class was unfunded as of 28 February 2003.
2. Transfers from the equities portfolio reflect the repatriation of dividends.
3. These net inflows consist of Member States’ contributions, less disbursements for loans, grants and administrative expenses.

IV. INVESTMENT INCOME

6. Market conditions during the first two months of 2003 were driven by the risk of a war in the Middle East and continued uncertainty about the economic outlook. Investors continued to favour government bonds as a safe haven, while equity markets also suffered from a fall in consumer confidence and from weak corporate earnings forecasts.

7. Table 2 shows net investment income for the first two months of 2003 and for earlier years for the investment portfolio’s major asset classes. Aggregate net investment income in the first two months of 2003 amounted to USD 14 447 000 equivalent (2002 – USD 26 170 000 equivalent). In line with market practice, capital gains and losses include both realized and unrealized gains and losses. All amounts are included on an accrual basis.

Table 2: Net Investment Income by Asset Classes
(USD ’000 equivalent)

Portfolio	**First Two Months 2003**	**2002**	**2001**	**2000**	**1999**	**1998**	**1997**
Internally managed portfolio	856	4 082	2 050	3 654	3 114	4 834	18 633
Government bonds portfolio	18 636	85 541	41 471	74 625	(43 977)	195 506	154 228
Inflation-indexed bonds portfolio	-	-	-	-	-	-	-
Diversified fixed-interest portfolio	6 608	22 925	13 783	17 615	3 832	6 130	-
Equities portfolio	(11 653)	(86 378)	(100 286)	(143 744)	231 500	(18 571)	(8 921)
Overall portfolio	**14 447**	**26 170**	**(42 982)**	**(47 850)**	**194 469**	**187 899**	**163 940**

8. Table 3 provides details of net investment income earned during the first two months of 2003 by major sectors of the portfolio.

Table 3: Investment Income on the Overall Portfolio – First Two Months of 2003
(USD ’000 equivalent)

	Fixed-Interest Portfolio	Equities Portfolio	Overall Portfolio
Interest from fixed-interest investments and bank accounts	10 244	-	10 244
Dividend income from equities	-	532	532
Realized capital gains (losses)	9 370	(935)	8 435
Unrealized capital gains (losses)	7 180	(11 109)	(3 929)
Subtotal: Gross investment income (loss)	**26 794**	**(11 512)**	**15 282**
Income from securities lending and commission recapture	13	3	16
Investment manager fees	(456)	(146)	(602)
Custody fees	(135)	(31)	(166)
Financial advisory and other investment management fees	(90)	(12)	(102)
Taxes	-	45	45
Other investment expenses	(26)	-	(26)
Net investment income (loss)	**26 100**	**(11 653)**	**14 447**

9. Table 4 shows net investment income for the sectors of the fixed-interest portfolio in the first two months of 2003. In aggregate, net income from fixed-interest investments amounted to USD 26 100 000 equivalent. All sectors of this portfolio, and especially the government bonds portfolio, contributed positively to income.

Table 4: Investment Income on the Fixed-Interest Portfolio – First Two Months of 2003
(USD ’000 equivalent)

	Internally Managed Portfolio	Government Bonds Portfolio	Diversified Fixed-Interest Portfolio	Total Fixed-Interest Portfolio
Interest from fixed-interest investments and bank accounts	876	7 793	1 575	10 244
Dividend income from equities	-	-	-	-
Realized capital gains (losses)	-	5 420	3 950	9 370
Unrealized capital gains (losses)	-	5 881	1 299	7 180
Subtotal: Gross investment income (loss)	**876**	**19 094**	**6 824**	**26 794**
Income from securities lending and commission recapture	-	11	2	13
Investment manager fees	-	(328)	(128)	(456)
Custody fees	(20)	(73)	(42)	(135)
Financial advisory and other investment management fees	-	(62)	(28)	(90)
Taxes	-	-	-	-
Other investment expenses	-	(6)	(20)	(26)
Net investment income (loss)	**856**	**18 636**	**6 608**	**26 100**

10. In aggregate, net losses from the equities portfolio in the first two months of 2003 amounted to USD 11 653 000 equivalent, as shown in Table 5 by sub-portfolio. The portfolio consisted of two sub-portfolios, North American and European equities, and both contributed negatively to income during the period.

Table 5: Investment Income on the Equities Portfolio – First Two Months of 2003
(USD ’000 equivalent)

	Emerging Markets Equities[1]	North American Equities	European Equities	Total Equities Portfolio
Interest from fixed-interest investments and bank accounts	-	-	-	-
Dividend income from equities	-	388	144	532
Realized capital gains (losses)	5	(201)	(739)	(935)
Unrealized capital gains (losses)	-	(4 599)	(6 510)	(11 109)
Subtotal: Gross investment income (loss)	**5**	**(4 412)**	**(7 105)**	**(11 512)**
Income from securities lending and commission recapture	-	-	3	3
Investment manager fees	-	(99)	(47)	(146)
Custody fees	(2)	(18)	(11)	(31)
Financial advisory and other investment management fees	-	(7)	(5)	(12)
Taxes	-	-	45	45
Other investment expenses	-	-	-	-
Net investment income (loss)	**3**	**(4 536)**	**(7 120)**	**(11 653)**

1 The portfolio was liquidated in October 2002. Income and expenses for the first two months of 2003 refer to transactions that could not be effected in 2002.

V. RATE OF RETURN AND PERFORMANCE COMPARISON

11. There was an overall positive return of 0.69% in the first two months of 2003, net of investment expenses and movements on exchange.

12. The performance of the various mandates of the investment portfolio is measured against preassigned independent benchmarks, indicating the return that would be expected through passive management of defined sectors of the market. The indexes used are the J.P. Morgan Global Government Bonds Index for government bonds, Lehman Brothers United States Aggregate Index for diversified fixed-interest bonds, Standard & Poor’s 500 Index for North American equities and Morgan Stanley Capitalization Index for European equities.

13. Table 6 compares the return of each major section of the portfolio with the appropriate benchmark rate of return. This information is presented graphically in Annex II. The overall portfolio showed an outperformance of 15 basis points in the first two months of 2003, with both fixed-interest and equities investments contributing to the outperformance.

Table 6: Performance Compared with Benchmarks

Portfolio	First Two Months of 2003		
	Return %		Out (Under) performance
	Portfolio	Benchmark	
Internally managed portfolio	0.22	0.22	0.00
Government bonds portfolio	1.87	1.74	0.13
Diversified fixed-interest portfolio	1.47	1.22	0.25
Total fixed-interest	**1.42**	**1.29**	**0.13**
North American equities	(3.64)	(4.39)	0.75
European equities	(9.13)	(8.74)	(0.39)
Total equities	**(5.48)**	**(5.77)**	**0.29**
Overall portfolio gross rate of return	**0.73**	**0.58**	**0.15**
Less expenses	**(0.04)**	**(0.04)**	**0.00**
Overall portfolio net rate of return	**0.69**	**0.54**	**0.15**

14. The total fixed-interest portfolio returned a positive 1.42% in the first two months of 2003 and outperformed its aggregate benchmark by 13 basis points. Both government bonds and diversified fixed-interest bonds contributed to the outperformance.

15. The total equities portfolio returned a negative –5.48% in the first two months of 2003, but outperformed its aggregate benchmark by 29 basis points. The outperformance was due to the North American equities portfolio, which was partially offset by an underperformance in the European equities portfolio.

16. A more detailed attribution of the portfolio's performance compared to benchmarks will be available for the entire first quarter of 2003. This information will be included in an annex to the next quarterly report.

VI. CURRENCY COMPOSITION

17. The majority of IFAD's commitments are expressed in Special Drawing Rights (SDRs). Consequently, the Fund's overall assets are maintained in such a way as to ensure that commitments for undisbursed loans and grants denominated in SDRs are matched, to the extent possible, by assets denominated in the currencies and in the ratios of the SDR valuation basket. Similarly, the General Reserve and commitments for grants denominated in United States dollars are matched by assets denominated in the same currency.

18. The Executive Board of the International Monetary Fund reviews the SDR valuation basket every five years to determine which currencies should be part of the basket and which percentage weight should apply to each currency at the date of the reweighting.

19. New units for each of the four currencies comprising the valuation basket were determined on 29 December 2000 so that the value of the SDR was precisely USD 1.30291 in terms of both the old and the new units, which became effective on 1 January 2001. The units applicable, together with their weights as of 1 January 2001 and 28 February 2003, are shown in Table 7.

Table 7: Units and Weights Applicable to the SDR Valuation Basket

	1 January 2001		28 February 2003	
Currency	**Units**	**Percentage Weight**	**Units**	**Percentage Weight**
USD	0.5770	44.3	0.5770	42.1
EUR	0.4260	30.4	0.4260	33.5
JPY	21.000	14.0	21.000	13.0
GBP	0.0984	11.3	0.0984	11.4
Total		**100.0**		**100.0**

20. As of 28 February 2003, assets in the form of cash, investments, promissory notes and amounts receivable from contributors under the Fourth and Fifth Replenishments amounted to USD 2 425 502 000 equivalent (31 December 2002 – USD 2 392 210 000 equivalent), as indicated in Table 8.

Table 8: Currency Composition of Assets at 28 February 2003
(USD '000 equivalent)

Currency Group	Cash and Investments	Promissory Notes	Amounts Receivable from Contributors	Total
USD	956 897	50 461	38 839	1 046 197
EUR	562 177	76 805	25 050	664 032
JPY	290 099	291	13 640	304 030
GBP	217 449	15 918	-	233 367
Other	105 914	54 208	17 754	177 876
Total	**2 132 536**	**197 683**	**95 283**	**2 425 502**

21. Holdings of assets denominated in currencies not included in the SDR valuation basket amounted to USD 177 876 000 equivalent at 28 February 2003 (31 December 2002 – USD 169 996 000 equivalent). These are allocated to currency groups, as indicated in Table 9.

Table 9: Allocation of Assets to Currency Groups at 28 February 2003
(USD '000 equivalent)

Currency Group	Currencies Included in SDR Basket	European Currencies Not Included in SDR Valuation Basket	Other Currencies Not Included in SDR Valuation Basket	Non-Convertible Currencies	Total Currencies per Group
USD	1 046 197	-	64 007	2 140	1 112 344
EUR	664 032	111 729	-	-	775 761
JPY	304 030	-	-	-	304 030
GBP	233 367	-	-	-	233 367
Total	**2 247 626**	**111 729**	**64 007**	**2 140**	**2 425 502**

22. The alignment of assets by currency group against the SDR valuation basket at 28 February 2003 is shown in table 10. The balance of the General Reserve at 28 February 2003 and the commitment for grants denominated in United States dollars on the same date amounted to USD 95 000 000 and USD 59 990 000 respectively.

Table 10: Alignment of Assets per Currency Group with the Currency Composition of the SDR Valuation Basket at 28 February 2003
(USD '000 equivalent)

Currency Group	Amount per Currency Group	Less: Commitment Denominated in USD	Net Assets per Currency Group	Net Assets % 28 February 2003	Compare SDR Weights % 28 February 2003
USD	1 112 344	(154 990)	957 354	42.1	42.1
EUR	775 761	-	775 761	34.2	33.5
JPY	304 030	-	304 030	13.4	13.0
GBP	233 367	-	233 367	10.3	11.4
Total	**2 425 502**	**(154 990)**	**2 270 512**	**100.0**	**100.0**

23. As of 28 February 2003, the currency group holdings of United States dollars were in line with the SDR valuation basket. There was a moderate excess of euro currency group and Japanese yen holdings, which were offset by a shortfall in British pound sterling holdings. Overall, variances against the SDR valuation basket were smaller than at 31 December 2002.

VII. RISK MEASUREMENT

24. The investment portfolio is subject to fluctuations in returns due to economic and market conditions. Historically, different asset classes have shown different levels of volatility, often referred to as 'risk'. Volatility is measured in terms of standard deviations of portfolio returns from their mean.

25. At 28 February 2003, the standard deviation of IFAD's policy allocation according to the current investment policy was 2.9%, compared to 2.1% for the actual portfolio, based on five years of historical monthly data.

26. Value-at-risk (VaR) is the measure of risk that IFAD uses to estimate the maximum amount the portfolio could lose over a three-month time horizon, with a 95% confidence level. Table 11 shows the VaR of IFAD's actual portfolio allocation and current policy allocation, based on five years of historical monthly data. At 28 February 2003, the VaR of the actual portfolio was the same as of 31 December 2002. The VaR of the actual portfolio remained significantly lower than the policy VaR due to the portfolio's currently high amount of cash and time-deposit holdings that are pending further investments in fixed-interest investments.

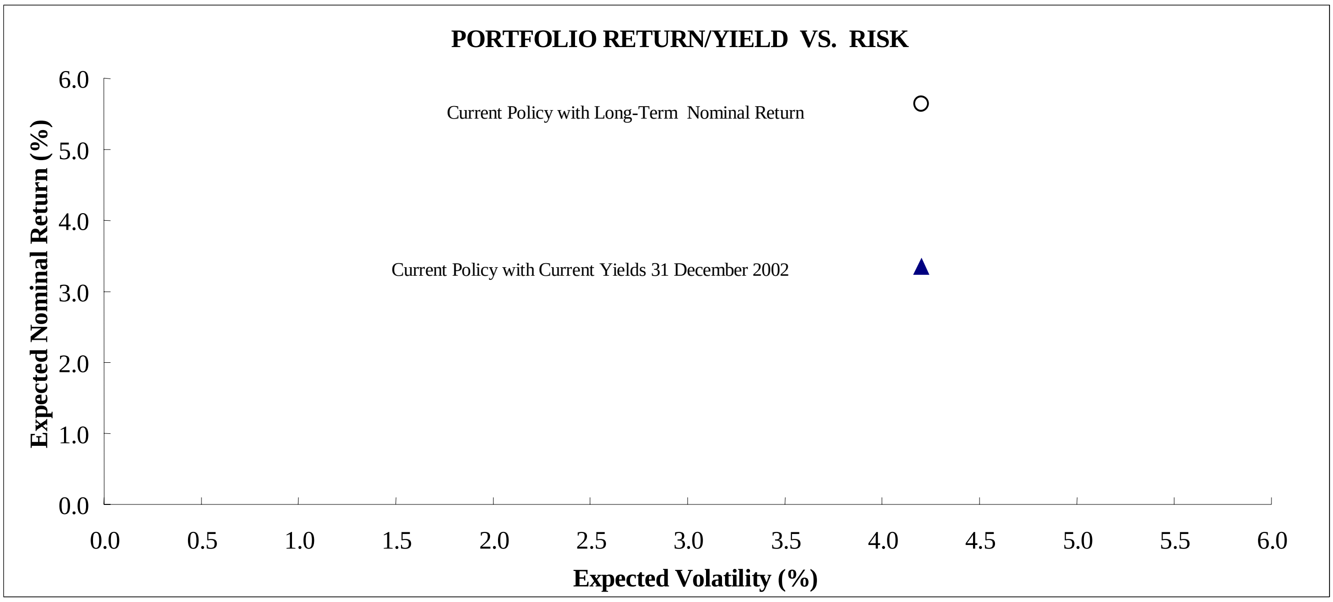
Table 11: Value-at-Risk
(Forecast horizon of three months – confidence level 95%)

Date	Portfolio		Policy[1]	
	VaR %	Amount USD '000	VaR %	Amount USD '000
28 February 2003	1.8	37 600	2.4	51 200
31 December 2002	1.8	38 100	2.4	50 300
30 September 2002	2.1	42 500	2.4	49 100
30 June 2002	2.5	49 000	2.4	46 800
31 March 2002	2.9	54 700	2.4	45 700
31 December 2001	5.5	105 100	6.2	119 100

[1] The new investment policy is reflected in the policy VaR as of 31 March 2002.

ANNEX I

CURRENT INVESTMENT POLICY – SUMMARY OF PORTFOLIO CHARACTERISTICS

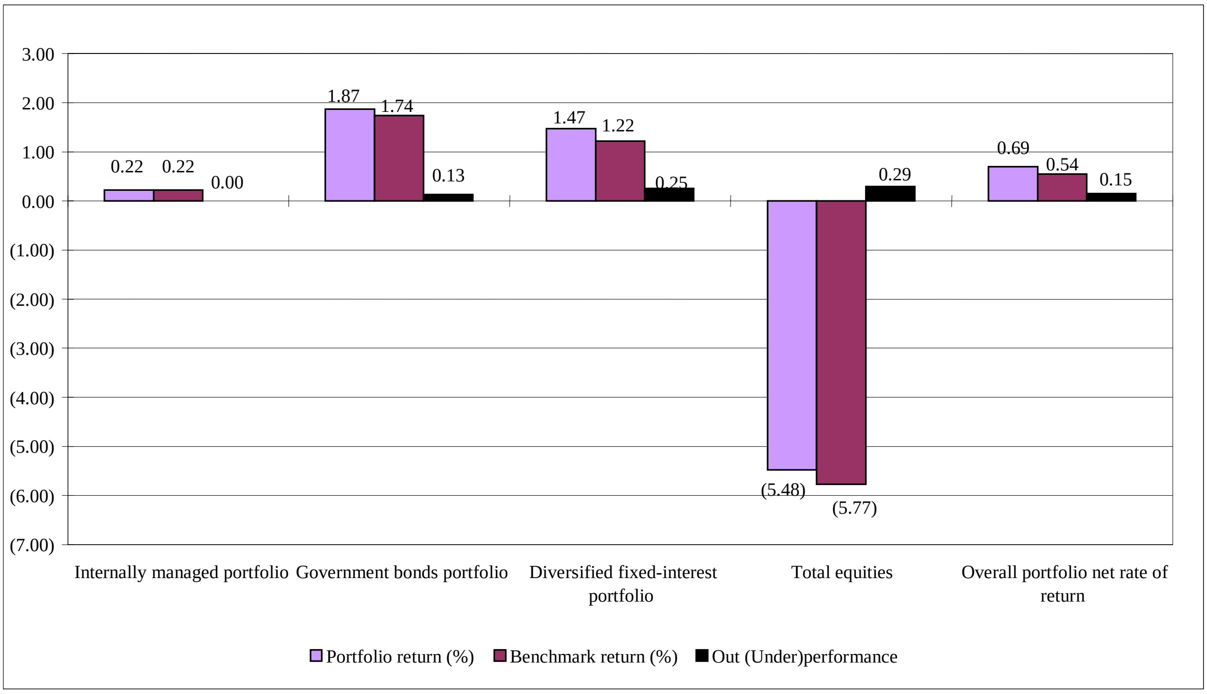


Asset[1]	Return & Risk Assumptions: Long-Term Nominal Return %	Return & Risk Assumptions: 31 December 2002 Current Yield %[4]	Return & Risk Assumptions: Long-Term Volatility %	Current Policy Allocations/Characteristics: Return = Long-Term Nominal Return %	Current Policy Allocations/Characteristics: Return = 31 December 2002 Current Yield[4]
Cash	3.0	1.8	2.9	5.0	5.0
Global government bonds	5.3	3.6	5.6	44.0	44.0
Diversified fixed-interest	5.6	3.7	6.0	23.0	23.0
Global inflation-indexed bonds	5.3	3.6	2.8	18.0	18.0
Global equities	9.2	1.9	15.9	10.0	10.0
Total %	5.6	3.4	4.2	100.0%	100.0%
Return					
(i) Expected coupon/dividend payments (USD million)[2]				98	98
(ii) Expected nominal return %				5.6	3.4
(iii) Probability % of achieving in 3 years a minimum average return of 3 %				88%	56%
(iv) Cumulative returns 3 years:					
Expected cumulative return %				17.9	10.4
Expected minimum cumulative return % (95% confidence level)				3.4	(4.1)
Expected maximum cumulative return % (95% confidence level)				32.5	25.0
Risk					
v) Expected volatility %				4.2	4.2
vi) Expected value-at-risk[3]				139	139
Risk-adjusted return					
vii) Sharpe ratio				0.63	0.37

[1] The credit floor for fixed-interest investments is AA-.
[2] Calculated for a total portfolio of USD 2 billion.
[3] Calculated in USD million with a one-year horizon and 95 % confidence level, on the basis of a total portfolio of USD 2 billion.
[4] The yields do not include capital gains, which are an element in the nominal return assumption, e.g. the yield shown for equities is the dividend rate.

PERFORMANCE YEAR-TO-DATE 2003

OVERALL PORTFOLIO



EQUITIES PORTFOLIO